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No. 85-554

IN THE

Supreme Court of the United States

October Term, 1985

UNITED STATES OF AMERICA,
Petitioner,

v.

HUGHES PROPEPTIES, INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF ATLANTIC CITY CASINO ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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BRIEF OF ATLANTIC CITY CASINO ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

STATEMENT OF INTEREST

The Atlantic City Casino Association (the "ACCA") is a not-for-profit corporation of the State of New Jersey. The ACCA represents all eleven operating casino hotels in Atlantic City, New Jersey: Adamar of New Jersey, Inc.; Bally's Park Place, Inc.; Boardwalk Regency Corp.; Castle Associates, a New Jersey Limited Partnership; Claridge at Park Place, Inc.; Elsinore Shore Associates; GNOC Corp.; Greate Bay Hotel and Casino, Inc.; Harrah's Associates, a New Jersey General Partnership; Marina Associates, a New Jersey General Partnership; and

Resorts International, Inc. ACCA members employ approximately 40,000 people.

Like respondent Hughes Properties, ACCA's members are licensed to conduct casino gaming operations subject to extensive state regulation. *See* N.J. Stat. Ann. §5:12-1, et seq. The Atlantic City casinos offer progressive jackpots on their slot machines under regulations established by the New Jersey Casino Control Commission. *See* N.J. Admin. Code §19:45-1:39 (pp. A-1 to A-4 *infra*.)[1]

All ACCA members are accrual-basis taxpayers, and all account for progressive jackpot liability on the accrual basis for financial statement purposes. Accordingly, ACCA has a concrete interest in the outcome of this case. The decision below follows the established principle that a definite liability may be deducted from income by an accrual-basis taxpayer even if the obligation has not yet been paid. The government challenges that decision on the primary ground that the payee (or jackpot winner) is not known at the time the expense is accrued. The government's argument, however, ignores the practical realities of the casino industry. In this pervasively regulated industry, there can be no question that progressive jackpots are a definite liability which may be deducted for tax purposes when they accrue.

INTRODUCTION AND SUMMARY OF ARGUMENT

The government challenges the deduction of the accrued liability for progressive slot machine jackpots on the basis of a single fact: that on the last day of a casino's tax year, "there exist[s] no person at all who could assert any possible claim to those funds." Pet. Br., p. 8;[2] *see id.*,

1. For the Court's convenience, certain New Jersey statutory and regulatory provisions relevant to the issues in this case are reproduced in an appendix to this brief (pp. A-1 to A-4).

2. This brief will refer to the Brief for the United States, filed January 30, 1986, as "Pet. Br., ____."

at 13 (identical phrase); *id.*, at 14 (if respondent sold its business, it would have "no liability, and would never have any liability, to pay the jackpots to anyone"); *id.*, at 21 ("respondent was not liable to anyone . . ."). To be sure, the government offers other rhetorical points. The government's brief discusses several decisions applying the "all events" test to accrual-basis taxpayers (*id.*, at 11-13, 18-21), expounds on the differences between tax accounting and financial accounting (*id.*, at 21-28), reviews legislative events in 1954 and 1955 which have no impact on this case (*id.*, at 28-29), and concludes with a call for vigilance against "tax avoidance" (*id.*, at 30-32).

The government's basic position, however, hinges on a single point: that at the end of the year no specific individual can claim an accrued progressive slot machine jackpot. That is the only "event" concerning liability which is not plainly established for the accrued progressive jackpots. Because the identity of the payee is unknown, the government insists, the obligation to pay that jackpot is not sufficiently fixed to allow deduction of the liability for tax purposes.

The government's argument betrays a fundamental ignorance about the pervasiveness of modern casino regulation, which is illustrated both by the Nevada regulations discussed by the Claims Court below and by the New Jersey regulations outlined in this brief. That extensive regulatory structure ensures that progressive jackpot liability is fixed, and that a casino licensee would risk serious sanctions if it manipulated its progressive slot machines for tax advantages in the manner imagined by the government.

Finally, the "all events" test does not bar deduction of an accrued liability by an accrual-basis taxpayer unless the identity of the payee is known. The "all events" test sets two requirements: that liability is established and that the amount of liability is reasonably ascertainable. State gaming regulations establish both the fact and the amount of liability for progressive slot machine

jackpots. That the payee cannot be identified is a peculiar factual circumstance which in no way alters the propriety of deducting the accrued liability for progressive slot machine jackpots.

I.

Casinos and Progressive Slot Machines Are Subject To Pervasive State Regulation

The lower courts allowed deduction of accrued progressive jackpots primarily because of Nevada's regulation of progressive slot machines. Petition for Certiorari, at 7a-9a (hereinafter "Petition"). As the Claims Court noted, the obligation to pay progressive jackpots "can be enforced by the Nevada Gaming Commission." *Id.*, at 14a. Indeed, that court concluded that "only the Nevada State Legislature can alter the 'guaranteed' jackpot liabilities of the casinos in that state." *Id.*, at 19a.

This important conclusion is powerfully reinforced by the example of New Jersey's regulation of casinos.[3] As the New Jersey Supreme Court wrote in *Knight v. Margate*, 86 N.J. 374, 380-81, 431 A.2d 833 (1981), in New Jersey "[t]he statutory and administrative controls over casino operations . . . are extraordinarily pervasive and intensive." Calling the regulatory scheme "both comprehensive and minutely elaborate," the state's highest court observed that "[o]ver 11 statutory articles and almost 200 separate provisions cover virtually every facet of casino gambling and its potential impact on the public." *Id.* at 381.

3. The revelance of the New Jersey experience was conceded in the government's petition for certiorari, which expressed alarm about the possible impact of this decision on the tax liability of New Jersey casinos. *See* Petition, at 16. The government's projection of the revenue consequences of the challenged deduction is subject to serious question, however. Indeed, in some years the accrual method may result in a smaller deduction than would cash-basis accounting, as appears to have been true for respondent Hughes Properties in 1976. *See* Petition, at 9a.

A. The Licensing Process

The heart of the New Jersey regulatory scheme is the licensing process. Each casino-hotel must be licensed after an extensive inquiry into the financial condition, operational plans, and integrity of the applicant and each of its officers, directors, principal employees, lenders, mortgagees, bond holders and investors. N.J. Stat. Ann. §§5:12-80 through 5:12-88; N.J. Admin. Code §19:41-3.1. There are further proceedings for licensing "casino key employees," §5:12-89, for licensing general casino employees, *id.*, §5:12-90, for registration of all hotel employees, *id.*, §5:12-91, for licensing of "casino service industries" (such as gaming equipment dealers, food and beverage suppliers, and garbage handlers), *id.*, §5:12-92, and for registration of all labor organizations for casino employees, *id.*, §5:12-93.[4] A casino license is subject to annual renewals by the Commission. *Id.* §5:12-139.

The licensing process can be grueling. Apparently strong applicants — such as Hilton Hotels Corporation — have been denied a license by the state Casino Control Commission.[5] Indeed, one Atlantic City licensee found its New Jersey license under challenge in 1982 due to its

4. *See Brown v. Hotel and Restaurant Employees and Bartenders Int'l Union Local 54*, 104 S. Ct. 3179 (1984) (state regulation of unions subject to Casino Control Act not preempted by federal labor law).

5. *See* "One Casino Wins, Another Loses," N.Y. Times, March 3, 1985, p. 6, col. 1. In *In re Boardwalk Regency Corp. Casino License*, 90 N.J. 361, 447 A.2d 1335, *appeal dismissed for want of substantial federal question sub nom. Perlman v. Attorney General of New Jersey*, 459 U.S. 1081 (1982), the New Jersey Supreme Court affirmed a decision denying a casino license unless the applicant totally removed two directors from its operations and from the operations of its unlicensed, non-New Jersey subsidiaries.

supposed violations of Puerto Rico's patently unconstitutional prohibition on casino advertising. *See* Jurisdictional Statement in *Posadas de Puerto Rico Associates v. Tourism Co. of Puerto Rico*, No. 84-1903, pp. 11-12.

Finally, the Casino Control Commission has at its disposal a broad range of sanctions for misconduct, including fines of up to $100,000, N.J. Stat. Ann. §§5:12-111 through 5:12-115, license revocation, *id.*, §5:12-129, or imposition of a conservatorship of indeterminate length, *id.*, §§5:12-130.1 through 5:12-130.11. Indeed, one casino was closed by Commission order on the Saturday after Thanksgiving for a regulatory violation.[6] The Nevada Gaming Commission has at its disposal a comparable array of tools for regulating casinos. *See* Nev. Rev. Stat. §463.310 (fines, suspension and revocation); *id.*, §463B.010, *et seq.* (authorizing appointment of "supervisor" to operate casino if license lapses or is suspended or revoked).

B. Slot Machine Regulation

The New Jersey slot machine regulations, like those in Nevada, are extensive. Each individual machine must be licensed as meeting uniform electrical and mechanical standards. N.J. Stat. Ann. §5:12-100(h). Each machine must display the manufacturer's serial number, a casino identification number, and a description of the rules of play. N.J. Admin. Code §19:45-1.37(a). No slot machine may be moved without written approval from the state and full recording of the status of the machine's jackpot. *Id.*, §19:45-1.38. Each slot machine "shall have a minimum payout of 83%," N.J. Stat. Ann. §5:12-100(e), thereby setting a floor under the odds on any slot machine. Jackpot payout procedures are painstakingly detailed. N.J. Admin. Code §19:45-1.40. If a licensee changes or modifies a slot machine without state approval, or otherwise violates the slot machine regulations, the licensee faces sanctions up to and including revocation of its casino license. N.J. Admin. Code §19:46-1.30.

6. "Casino Panel Shuts Caesars on Nov. 30," Atlantic City Press, Oct. 10, 1985, p. 1.

New Jersey has special regulations concerning progressive slot machines. No progressive slot machine may be installed until the Casino Control Commission approves "[t]he initial and reset amounts" for the machine's meters, the machine's security system, and the "proposed rate of progression for each machine." N.J. Admin. Code §19:45-1.39(e).

Like Nevada, New Jersey requires that no meter on a progressive slot machine "shall be turned back to a lesser amount unless the amount indicated has been actually paid to a winning patron," or has been recorded for prompt payment under Commission rules, or, in case of a mechanical breakdown, unless the jackpot amount has been transferred to another progressive slot machine as approved by the Commission. *Id.*, §19:45-1.39(f) and (k). Moreover, once a progressive slot machine has been installed, "the rate of progression and the probability of hitting the combination that will award the progressive jackpot may not be changed until there has been a winner of the payout amount registered" or the payout limit has been reached. *Id.*, §19:45-1.39(g). Consequently, the odds on winning the progressive jackpot amount cannot be changed once they have been set. The progressive jackpots also are subject to the general requirement that slot machines have a payout rate of 83 percent, although the actual payout rate is often higher. *See Casino Chronicle*, Dec. 1985, p. 4 (for all Atlantic City casinos, slot machine payout rate for month was 87.5%).

Thus, the state of New Jersey must approve the installation of every progressive slot machine and the machine's rate of progression. No progressive slot machine meter can be turned back and neither the rate of progression nor the odds of winning can be changed. The progressive slot machines must pay out at a rate of at

least 83 percent. If a machine malfunctions, it may be removed from the floor so long as it is returned within five days or, if not returned, so long as its progressive jackpot amount is added to another progressive slot machine in a manner approved by the Commission. Violations of these requirements can result in monetary sanctions or suspension or revocation of a casino license.

II.

Under The "All Events" Test, Progressive Jackpots May Be Deducted As An Accrued Liability

Congress has authorized the deduction from income of accrued but unpaid liabilities so long as the taxpayer reports his entire income on an accrual basis and so long as there is no resulting distortion of the taxpayer's income. I.R.C. §§446, 461. In *United States v. Anderson*, 269 U.S. 422 (1926), the Supreme Court explained the wisdom of that policy. Writing for the Court, Justice Stone noted that the taxpayer's "true income for the year [ ] could not have been determined without deducting from its gross income for the year the total cost and expenses attributable to the production of that income during the year." *Id.*, at 440. Deduction of an unpaid expense by an accrual-basis taxpayer, Justice Stone continued, is necessary when "all the events" have occurred which "fix the amount" of an expense and "determine the liability of the taxpayer to pay it." *Id.*, at 441.

As Justice Brandeis wrote later, the all-events test is "a practical, not a legal, test" which allows deduction of "*losses which are so reasonably certain in fact and ascertainable in amount as to justify their deduction . . . before they are absolutely realized.*" *Lucas v. American Code Co.*, 280 U.S. 445, 449 (1930) (emphasis added). As an example, in *American National Co. v. United States*, 274 U.S. 99 (1927), the Court allowed an accrual-basis taxpayer to deduct bonuses payable to investors over the next five years.

In this case, at the close of the tax year the casino licensee has a definite obligation to pay the progressive jackpot amount in the future. By state order, the casino cannot turn back or reduce the jackpot amount, nor can a New Jersey casino change the odds on any progressive slot machine. Indeed, the payout on slot machines in Atlantic City is set by law at no less than 83 percent.

The fixed quality of the accrued jackpot may be illustrated by viewing that obligation in different contexts. Any party purchasing a casino property would have to recognize the accrued progressive jackpots as a liability to be assumed. A license applicant could hardly expect the Commission to award a license to an applicant that intended to repudiate pre-existing progressive jackpot obligations. In addition, if a casino license is suspended or revoked, the Commission may appoint a conservator who would assume "any and all valid liens, claims, and encumbrances," N.J. Stat. Ann., §5:12-130.2, plainly including the progressive jackpots. *Compare* Nev. Rev. Stat. §463B.130 (supervisor appointed under Nevada law assumes "liens, claims and encumbrances" against gaming establishment). Indeed, one Atlantic City licensee recently sought protection under Chapter 11 of the federal bankruptcy laws, but its operations — including progressive slot machine jackpots — have continued.[7]

Of course, as the government pointed out in its Reply Memorandum to the opposition to the certiorari petition (p. 3) the government's position is not based on the remote possibility that a casino might go bankrupt and fail to pay accrued progressive jackpots.

> Remote contingencies like bankruptcy, which might serve to divest respondent of its obligation on liabilities once they have become fixed, are properly regarded as "conditions subsequent." It is well settled that conditions of the latter sort do

7. *See* "Elsinore Late With Interest," Atlantic City Press, Jan. 16, 1986, p. 1, col. 1.

not preclude accruals under the "all events" test, and we are not contending otherwise.[8]

What is left of the government's argument, then, is the fact that at the close of the tax year no individual can assert a claim to the progressive jackpot. It is on this fact alone that the government's position succeeds or fails.

The "all events" test has never included a requirement that the ultimate payee be identified before an obligation is "so reasonably certain in fact" as to be deductible. The Treasury Regulations require only that "all the events have occurred which determine the *fact* of the liability" and that "the amount thereof can be determined with reasonable accuracy." 26 C.F.R. 1.461-1(a)(2) (1985) (emphasis added). Nothing in the regulation or in any prior decision requires that the identity of the payee also be established

It is surely an unusual case in which the fact of liability can be established without knowing the identity of the payee. But the extraordinary and pervasive regulation of the casino industry creates just such unusual circumstances with respect to liability for progressive jackpots. The practical test required for the all-events test establishes that the casino's liability for the progressive jackpot is fixed. As the Court of Claims held in allowing deduction of accrued contributions to a profit-sharing plan even when the identity of the ultimate recipients was not known, "it is the certainty of the liability which is of utmost importance in the 'all events' test, and not necessariiy either the certainty of the time over which payment will be made or the identity of the payees." *Washington Post Co. v. United States*, 405 F.2d

8. Similarly, the Ninth Circuit has held that a Nevada casino which was an accrual-basis taxpayer had to report as accrued income all "markers" held from patrons, even though the casino would not be able to collect on all of those markers. *Flamingo Resort, Inc. v. United States*, 664 F.2d 1387, 1390-91 (9th Cir.), *cert. denied*, 459 U.S. 1036 (1982).

1279, 1284 (Ct. Cl. 1969). Because state regulations establish with a reasonable certainty the fact of a casino licensee's liability to pay progressive slot machine jackpots, the accrued liability for those jackpots is deductible under the "all events" test even though the identity of the payee is unknown.[9]

9. The balance of the government's arguments are essentially makeweights. *First*, the 1954 statute concerning accrued deductions was repealed in 1955 at the request of the Secretary of the Treasury, who agreed that the repeal would "operate simply to reestablish the principles of law which would have been applicable if [the statute] had never been enacted." H.R. Rep. No. 293, 84th Cong., 1st Sess. 5 (1955); *see* S. Rep. No. 372, 84th Cong., 1st Sess. 5-6 (1955). *Second*, that tax accounting and financial accounting sometimes diverge is scarcely a matter for celebration, but is an unfortunate development to be avoided, if possible. As Justice Stone noted concerning the predecessor to §446, the purpose of that provision was to allow taxpayers to prepare tax returns "made on the basis on which the taxpayer's books were kept," including the accrual basis. *Anderson, supra*, 269 U.S. at 439; *see Eastman Kodak Co. v. United States*, 534 F.2d 252, 258 (Ct. Cl. 1976), ("our goal should be to reconcile business and tax treatment of an item, rather than to drive them farther apart"). *Third*, the government's dark references to possible "tax avoidance" schemes are unsupported in this record and unrealistic in view of the strict state regulations outlined above.

CONCLUSION

For all of the foregoing reasons, the decision below should be affirmed.

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APPENDIX OF STATUTES AND REGULATIONS

New Jersey Statutes Annotated, §5:12-100(e):

All gaming shall be conducted according to rules promulgated by the commission . . . . Each slot machine shall have a minimum payout of 83%.

New Jersey Administrative Code, §19:45-1.39, Progressive Slot Machines:

(a) This section shall apply to any slot machine with a "progressive meter(s)" that increases as the machine is played.

(b) Unless otherwise authorized by the Commission, each progressive slot machine in a casino shall have the following identifying features:

1. A mechanical, electrical or electronic device, to be known as a "progressive meter(s)", visible from the front of the machine which increments at a set rate of progression with coins placed into the machine, and which advises the player of the amount which can be won if the progressive jackpot combination appears;

2. A mechanical, electrical or electronic device, to be known as a "progressive jackpot meter" that is visible without opening the door and that continuously and automatically records the number of times a progressive jackpot is hit;

3. A separate key and key switch to reset the "progressive meter(s)" or such other separate reset mechanism as may be approved by the Commission;

4. A separate key locking the compartment housing the progressive meter(s) or other means by which to preclude any unauthorized alterations to the progressive meters.

(c) Unless otherwise authorized by the Commission, each progressive slot machine connected to a common progressive display unit shall:

1. Be of the same denomination and have the same probability of hitting the combination that will award the progressive jackpot as every other machine connected to such display unit;

2. Require that the same number of coins be inserted to entitle the player to a chance at winning the progressive jackpot and each coin shall increment the meter(s) by the same rate of progression as every other machine connected to such display unit; and

3. Have its microprocessor or other control unit that controls the common display unit housed in a location which would allow dual key control of the Commission and the casino licensee, or with such other key controls as the Commission may approve.

(d) Every casino seeking to utilize a progressive slot machine connected to a common progressive display unit shall submit to the Commission for approval the location and manner of installing the common progressive display unit.

(e) No progressive slot machine shall be placed on the casino floor until the casino licensee has submitted to the Commission and the Commission has approved the following:

1. The initial and reset amounts at which the "progressive meter(s)" will be set;

2. The proposed system for controlling the keys and access codes to these machines; and

3. The proposed rate of progression for each machine;

(f) No "progressive meter(s)" shall be turned back to a lesser amount unless the amount indicated has been

actually paid to a winning patron, or the progressive jackpot amount won by the patron has been recorded in accordance with an approved system of internal controls, or the change in the meter(s) reading is necessitated by a slot machine or meter(s) malfunction, in which case an explanation must be entered on the Progressive Slot Summary required in (j) below and the Commission inspector must pre-approve the resetting in writing.

(g) Once an amount appears on a "progressive meter(s)", the rate of progression and the probability of hitting the combination that will award the progressive jackpot may not be changed until there has been a winner of the payout amount registered on the meter(s) or the payout limit, as described in subsection (i) of this section, is registered on the "progressive meter(s)".

(h) If the "progressive meter(s)" progresses without a payout until the meter(s) returns to zero because of digital limitations on the meter(s), some means must be utilized to clearly advise the patrons of the value of the undisplayed digit.

(i) The payout limit, if any, shall be posted on the slot machine and shall be clearly visible to the patron.

(j) The amount indicated on the "progressive meter(s)" and "in meter" on each slot machine shall be recorded on a Progressive Slot Summary, at a minimum, once each day and such summary shall be signed by the preparer. Supporting documents shall be maintained to explain any reduction in the registered amount from the previous entry and shall indicate the date, casino number of the slot machine, and the amount of the reduction.

(k) Unless otherwise authorized by the Commission, a progressive slot machine removed from the gaming floor shall be returned to or replaced on the gaming floor within five days. The amount on the "progressive meter(s)" on the returned or replacement machine shall not be less than the amount on the "progressive meter(s)" at the time of removal. If the machine is not returned or replaced, then the "progressive meter(s)"

amount at the time of removal shall be added to like machine or machines as approved by the Commission.

New Jersey Administrative Code, §19:46-1.30, Disciplinary Procedures:

(a) Any changes or modifications found in a slot machine that have not been approved by the commission in advance, or any circuitry of any kind or manner which changes or alters the manner of operation from that which was approved by the commission or has been represented to the public, or any other circuitry changing or altering the manner and mode of operation that was not discovered by the division or commission at the time of licensing the machine or any other violation of these regulations shall constitute cause for sealing or seizing any or all of the slot machines manufactured, distributed or utilized by a licensee and further shall constitute cause for limiting, conditioning, restricting, suspending or revoking the license of the licensee or fining said licensee.

(b) Prior to seizure of all machines of a manufacturer, distributor or operator pursuant to subsection (a), a reasonable effort may be made to determine if the change has occurred in all or in part of the machines and may provide the opportunity for an investigative hearing. In any case in which seizure may be effected prior to the opportunity for a hearing, an investigative hearing must be conducted as soon as practical subsequent to the seizure.